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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

NOS. 242 AND 243.

IN THE MATTER OF THE REORGANIZATION OF PITTSBURGH RAILWAYS COMPANY, a Corporation, Debtor, and PITTSBURGH MOTOR COACH COMPANY, a Corporation Subsidiary.

PHILADELPHIA COMPANY and Certain Underliers, Petitioners,

v.

WALTER L. DIPPLE, JAMES P. McARDLE, BEN PAUL BRASLEY and THOMAS J. HOFFMAN, a Committee Known as the Tort Creditors' Committee, and CITY OF PITTSBURGH, Respondents.

REPLY BRIEF FOR PETITIONERS.

On Writs of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

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REPLY BRIEF FOR PETITIONERS.

The respondents, in their brief filed with the Court below, and the Circuit Court of Appeals, in its opinion, misconceived petitioners' contention in this case. It was thought that that misunderstanding would be dispelled by the brief filed by petitioners in this Court. Apparently, however, respondents have continued to misinterpret petitioners' argument. It is with the hope that petitioners' position may be clarified that this reply brief is filed.

Much of respondents' brief is devoted to the argument that the separate corporate entities of the debtor and the various underliers should be strictly maintained. With this contention petitioners do not quarrel. But

respondents' argument is based upon the assumption that petitioners seek to have this Court treat the debtor and underliers as if they were one corporation. This is not so. Petitioners recognize that the underliers are separate and distinct entities to be so treated for all purposes. Neither the debts, obligations, undertakings nor torts of one should be visited upon another. But no such problem is involved. The question presented by this case is—*Shall the trustees pay the taxes of the debtor and each of the underliers?*

The Trustees are three individuals. They are not a corporation. They are not possessed of nor are they exercising the corporate franchise of either the debtor or any of the underliers. The debtor and each underlier has and maintains its separate corporate organization and franchise. Each has its officers and its board of directors. The trustees are not concerned with these, either in the case of the underliers or the debtor. Petitioners do not seek to treat the trustees as a corporation or to substitute them for the corporate entities of the debtor or any of the underliers as petitioners recognize them as separate independent agents appointed by the District Court. How, then, can it be said that any question of the recognition or nonrecognition of separate corporate entities is involved? Yet the problem continues to be *shall the trustees pay the taxes of the underliers as well as of the debtor?*

The trustees, as agents of the District Court, have taken possession of and are operating all the properties of the debtor. As such they have also taken possession of and are operating all the properties of each of the underliers. Their possession of one is no more complete than their possession of the other. If then, it be conceded that they are operating the business of one, how can it be denied they are operating the business of all? *And this is the true crux of the case.* For under the

Act of June 18, 1934,* referred to in petitioners' original brief, as well as under the general rule established by the decisions of this Court therein cited, if the trustees are operating the businesses of the underliers they must pay all taxes applicable to those businesses whether the underliers are one or many separate entities.

Respondents entirely overlook a very important fact. The trustees have not affirmed or rejected the leases and operating agreements which exist between the debtor and the underliers. Had the trustees affirmed those leases and agreements, their position would be that of lessees or operators under contract who, by adoption, had made the leases and agreements as effectively their own as if they were the original parties thereto. On the other hand, if the trustees had rejected those leases and agreements, the estate of the debtor would be liable for breach of contract and for use and occupation by the trustees. But during the trial period, the trustees operate the business and properties of the underliers by virtue of the power vested in them by law as appointees of the Court. Their liability for taxes follows from this fact of operation only and is not based on any contract. The respondents' assumption, that the liability of the trustees for the underliers' taxes in this case is derived from what would be the source of the debtor's liability for such taxes had it continued to operate under the leases and operating agreements, is utterly fallacious. The respondents' entire first point, to wit, that there is no tax liability upon the trustees by virtue of the leases and operating agreements is, therefore, entirely beside the point and is conceded by the petitioners. Indeed, they base their position upon it. Petitioners contend that the trustees are operating the businesses of the underliers by virtue of their ap-

* 48 Stat. 993 (28 U. S. C. A. Sec. 124(a)).

pointment by the District Court, and it follows, under the statute and general law, that they must pay the taxes assessed against such businesses. If and after the trustees affirm or reject the leases and operating agreements, a different problem arises which is not here presented.

Cast aside, then, the contentions of respondents that "separate corporate structures will not be erased" and "taxes assessed against the underliers cannot be paid as advances on use and occupancy".* For clarity of vision, look at the problem from another approach. Start with the statute and the federal decisions. Under the general principle of the cases, buttressed, as to state and local taxes, by the Act of June 18, 1934, the trustees must pay the taxes assessed in respect of the business of the underliers *if* the trustees are conducting their businesses. Are the trustees conducting the business of the underliers? It is submitted there can be no doubt that they are. Read carefully and analyze respondents' argument on this, the real question.** Aside from references to the doctrine of use and occupation allowances under rejected leases, to the doctrine of separate corporate entities and to the fact that there is no tax obligation upon the trustees under the leases and operating agreements, all of which are beside the point, the respondents do no more than assert that the trustees are not operating the underliers' businesses. Respondents advance no reasons from which such a conclusion can be reached. They merely assert it. In fact, sound reasoning and reported judicial thinking support petitioners' position that the trustees are operating the underliers' businesses. As has been previously stated, the trustees, by virtue of the authority vested in them by

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* Respondents' third and fourth points.

** Respondents' second point.

the District Court, are in as full control of and are exercising as complete domination over the businesses of the underliers as they are over that of the debtor. The business of each of the underliers and the purpose of their formation is and was the operation of passenger street railways. These railways are being operated by the trustees who are in possession of all the properties of the underliers. This is the only business the underliers have. Nothing remains in the hands of the underliers except their bare corporate organization, *i. e.*, their officers and boards of directors, and this is equally true of the debtor. In *McCoach v. Minehill & S. H. R. Co.*, 228 U. S. 295, 57 L. Ed. 842, this Court has held that where a railroad leases all of its track and properties to another, it is no longer doing business. Its business is conducted by the lessee. In the case cited the pertinent facts were stated by the Court as follows:

> "Pursuant to this lease the entire railroad and all property connected therewith was turned over to the Reading Company, and since then has been operated by that company, and the Minehill Company has not carried on any business in connection with the operation of it. It has, however, maintained its corporate existence and organization by the annual election of a president and board of managers, and this board has annually elected a secretary and treasurer. It receives annually from the Reading Company the fixed rental called for by the lease; and it receives annually sums of money as interest on its bank deposits, and also maintains a 'contingent fund,' from which it receives annual sums as interest or dividends. And it annually pays the ordinary and necessary expenses of maintaining its office and keeping up the activities of its corporate existence, including the payment of salaries to its officers and clerks. It keeps and maintains at its office, stock

books for the transfer of its capital stock, and this stock is bought and sold upon the market. The annual income from the contingent fund appears to be about $24,000, its annual payments for state taxes about as much, and its expenditures for corporate maintenance about $5,000.

"The corporation tax law (act of August 5, 1909, § 38, 36 Stat. at L. chap. 6, pp. 11, 112-117, U. S. Comp. Stat. Supp. 1911, pp. 741, 946-951) provides:

" 'That every corporation * * * organized for profit and having a capital stock represented by shares * * * and engaged in business in any state * * * shall be subject to pay annually a special excise tax with respect to the carrying on or doing business by such corporation * * * equivalent to one per centum upon the entire net income over and above $5,000, received by it from all sources during such year, exclusive of amounts received by it as dividends upon stock of other corporations * * * subject to the tax hereby imposed.' " (P. 844)

The Court held as follows:

"From the facts as stated above it is entirely clear that the Minehill Company was not, during the years of 1909 and 1910, engaged at all in the business of maintaining or operating a railroad, which was the prime object of its incorporation. This business, by the lease of 1896, it had turned over to the Reading Company. If that lease had been made without authorization of law, it may be that for some purposes, and possibly for the present purpose, the lessee might be deemed in law the agent of the lessor; or, at least, the lessor held estopped to deny such agency. But the lease was made by the express

> authority of the state that created the Minehill Company, conferred upon it its franchise, and imposed upon it the correlative public duties. The effect of this legislation and of the lease made thereunder was to constitute the Reading Company the public agent for the operation of the railroad, and to prevent the Minehill Company from carrying on business in respect of the maintenance and operation of the railroad so long as the lease shall continue. And it is the Reading Company, and not the Minehill Company that is 'doing business' as a railroad company upon the lines covered by the lease, and is taxable because of it." (P. 846)

The leases and operating agreements under which the debtor operated the business and properties and franchises of the underliers were likewise authorized by Pennsylvania statutes. See Act of 1895, P. L. 63, Sec. 1, 67 Purdons, Sec. 1279; and Act of 1895, P. L. 64, Sec. 1, 15 Purdons, Secs. 1894 and 1895, which are set out in the appendix hereto.

Therefore, prior to the filing of its original petition, the debtor was operating the businesses of the underliers. Equally, the trustees are now operating those businesses. It follows, under the Act of June 18, 1934, and accepted general legal principles, that the trustees must pay the taxes assessed in respect of the underliers' businesses so long as operated by the trustees.

Respondents cite the committee report on the Act to the effect that its purpose is to subject *businesses conducted* under federal receivership to taxes the same as if *such businesses* were being conducted by private individuals. On this basis, respondents attempt to confine the application of the governing statute and general rule to taxes that were taxes, as such, of the debtor itself prior to commencement of reorganization proceedings.

What a complete *non sequitur*. It may well be that the *debtor's* obligation to pay underliers' taxes was not a tax obligation. On pages 14 and 15 of respondents' brief, they cite several cases to prove the point that *debtor's* obligation was a contractual not a tax obligation. But clearly it does not follow that the trustees are not bound to pay the taxes. As pointed out by the District Court in its opinion (R. 80), the trustees are, without objection, paying the expenses of maintaining the property of the underliers and real estate taxes assessed thereon to the respondent, the City of Pittsburgh, and other municipalities. If the trustees are now conducting the businesses of the underliers, they are bound by statute and general law to pay the taxes of the underliers. This principle is clearly supported by the decision of this Court in *Warren v. Palmer*, 310 U. S. 132, 84 L. Ed. 1118, in which it was said:

> "This Court has held 'upon principles of general application' that courts having custody of property or a fund have the power 'to require that expenses which have contributed either to the preservation or creation of the fund in its custody shall be paid before a general disposition among those entitled to receive it.' Such a power reposes in any court charged with custody of property. It is an in rem jurisdiction springing from possession of the property which is necessary in order that the court may adequately care for the property." (pp. 1123, 1124)

Sec. 124 (a) (the Act of June 18, 1934) never intended to confine the trustee's obligation to pay taxes to those taxes paid by the debtor as a tax obligation. The purpose is broader. As stated by the committee report quoted by respondents on page 20 of their brief "No good reason is perceived why a receiver should be permitted to operate under such an advantage as

against his competitors not in receivership, and the states and local governments be deprived of this revenue." This reasoning compels payment of all taxes on *all businesses conducted by the trustees*, irrespective of the nature of the debtor's obligation to pay taxes as it existed prior to institution of the reorganization proceedings.

CONCLUSION.

The trustees are operating the businesses of the underliers. It follows. under general principles as announced by federal decisions as to all taxes and under the Act of June 18, 1934, as to state and local taxes, that the trustees must pay the taxes assessed in respect of all businesses conducted by the debtor. Had respondents directed their brief to this issue, the only real issue, petitioners would have rested on their original brief, believing their position to be unassailable. It has been the purpose of this reply brief to clarify the issue. Petitioners respectfully submit that the judgment of the Circuit Court of Appeals for the Third Circuit should be reversed and the order of the District Court affirmed.

Respectfully submitted,

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Attorneys for Philadelphia Company and Certain Underliers, Petitioners.

APPENDIX.

The Act of 1895, P. L. 63, Sec. 1, 67 Purdons, Sec. 1279, reads as follows:

"§ 1279. Sale or lease of property and franchises to traction or motor-power companies

"Any street passenger railway company heretofore or which may hereafter be incorporated in this commonwealth, under general or special laws, whose line or lines are not on township or country roads, is hereby authorized to sell or to lease, or to lease and to sell its property and franchises to any traction or motor-power company incorporated under the laws of this commonwealth, not operating a line or lines of railway on township or country roads, upon such terms as shall be agreed upon."

The Act of 1895, P. L. 64, Sec. 1, 15 Purdons, Secs. 1894 and 1895, reads as follows:

"§ 1894. Traction or motor-power companies may sell or lease property and franchises

"Any traction or motor-power company heretofore or hereafter incorporated under the laws of this commonwealth is hereby authorized to sell or to lease, or to lease and to sell its property and franchises, as well those owned as those leased, operated or controlled by it, including so much of any line or lines of passenger railways owned, leased or controlled by it as is located upon street or streets, to any other traction or motor-power company incorporated under the laws of this commonwealth, upon such terms as may be agreed upon.

"§ 1895. May contract for operation of lines

"Such traction or motor-power company may also enter into contracts with other traction or motor-power companies incorporated under the laws of this commonwealth, for the operation of lines of railway and property owned, leased, operated or controlled by it: Provided, That nothing herein contained shall be construed as authorizing any traction or motor-power company to acquire, lease or operate so much of the line of any other motor-power company as occupies any township, borough or county road."